

**Joint Legislative Budget Committee
Staff Memorandum**

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DATE: October 18, 2005

TO: Members, Joint Legislative Budget Committee

FROM: Richard Stavneak, Director

SUBJECT: FY 2006 REVENUE AND ENDING BALANCE PROJECTION

Pursuant to Laws 2005, Chapter 286, the JLBC Staff is required to report to the Committee by October 15, 2005 as to whether the estimated revenue and ending balance for FY 2006 are expected to change by more than \$50 million from budgeted projections.

The JLBC Staff does anticipate that FY 2006 revenues and the FY 2006 ending balance will exceed the budget by more than \$50 million. As discussed below, there are three main factors which we anticipate will influence the magnitude of the increase.

FY 2005 Revenue Performance

Laws 2005, Chapter 286 established a FY 2005 General Fund revenue forecast of \$7,629.3 million. Preliminary actual revenue collections exceeded the forecast by approximately \$320 million. The legislation as passed included a provision to transfer any excess revenue collections into the Budget Stabilization Fund (BSF). However, the Governor line-item vetoed the BSF transfer provision for excess FY 2005 revenue. As a result, the \$320 million in excess revenue collections will carry forward into FY 2006. This estimate may change somewhat due to final accounting adjustments.

FY 2006 Revenues

The enacted FY 2006 budget was based on total revenues of \$8.25 billion. This amount assumed a growth rate of 7.4% in permanent on-going revenues.

As noted above, FY 2005 revenues were \$320 million higher than expected. This higher base means that we could expect an additional \$344 million in revenues if we were to keep the 7.4% growth rate for FY 2006.

However, fiscal year-to-date revenue collections suggest that the FY 2006 growth rate will be greater than 7.4%. Based on preliminary data, General Fund revenues were 20.4% above FY 2005 through the first 3 months of the fiscal year.

JLBC

We are unlikely to sustain growth at the first quarter rate for the remainder of the fiscal year, as the housing market stabilizes and interest rates increase. The JLBC's four-sector consensus provides forecasts from the Finance Advisory Committee, the base and low forecasts from the University of Arizona econometric models, and the JLBC Staff forecast. As discussed at the September 15, 2005 Finance Advisory Committee meeting, the current FY 2006 consensus projection is a 9.1% growth rate. While this projection will likely increase later in the year, the 9.1% growth rate would increase revenues another \$140 million above the original 7.4% budget forecast.

Not all of the excess FY 2006 revenue, however, will remain in the General Fund. Laws 2005, Chapter 286 requires that excess FY 2006 General Fund revenues over the enacted budget forecast be deposited into the BSF (unlike the FY 2005 language, the FY 2006 provision was not vetoed). Combining the \$344 million from a higher base with the \$140 million from a higher rate would result in excess FY 2006 revenues of \$484 million.

There is permanent statutory language that could limit the size of the BSF deposit. A.R.S. § 35-144 H limits the BSF balance at the end of a fiscal year to 7% of the fiscal year's revenues. If this language is interpreted to cap the Laws 2005, Chapter 286 deposit requirement, it would occur if excess revenues exceeded \$417 million. Since the current "excess" projection is \$484 million, the cap could come into effect, and \$67 million would remain in the General Fund.

FY 2006 Spending Shortfalls

The FY 2006 ending balance will also depend on whether we meet spending projections. At this time, the JLBC Staff is monitoring 3 possible shortfalls totaling \$61 million:

- *Arizona Department of Education*: FY 2005 student growth was 3.5%, compared to the 2.9% budgeted rate. As a result, the budgeted FY 2006 student count is probably too low. JLBC Staff preliminarily estimates that the higher student growth will result in a \$(32) million shortfall. The Department has estimated its shortfall at \$47 million.
- *AHCCCS*: At the September 1 JLBC meeting, JLBC Staff estimated that AHCCCS Long Term Care inflation, which will be 14.3% instead of 5.5% assumed in the FY 2006 appropriation, could result in a \$(14) million shortfall. Lower-than-expected caseloads in AHCCCS programs could reduce this shortfall.
- *Department of Health Services (DHS)*: At the July 21 JLBC meeting, JLBC Staff estimated that DHS' decision to increase capitation rates to expand services for Maricopa County's Seriously Mentally Ill population could result in a \$(15) million shortfall. The expansion was made without Legislative approval. As with AHCCCS, lower-than-expected caseloads could reduce this shortfall.

Summary

The enacted FY 2006 budget had an estimated FY 2006 ending balance of \$31.5 million. The following chart summarizes potential gains and losses to this amount of \$326 million as previously described in this memo. This estimate will be subject to considerable change during

the remainder of the fiscal year, especially with regard to the FY 2006 revenue growth rate and the shortfall estimates

Potential Adjustments to FY 2006 Ending Balance

	<u>\$ in millions</u>
◆ Unanticipated FY 2005 revenues	\$ 320
◆ Excess FY 2006 revenues (based on higher FY 2005 base)	344
◆ Higher FY 2006 growth rate	140
◆ FY 2006 Budget Stabilization Fund transfer	(417)
◆ Potential Arizona Department of Education shortfall	(32)
◆ Potential AHCCCS shortfall	(14)
◆ Potential Department of Health Services shortfall	(15)
Total – Potential Adjustments to Ending Balance	<hr/> \$ 326 <hr/>

Rather than the budgeted FY 2006 ending balance of \$31 million, these adjustments would raise that estimate by \$326 million to \$357 million. These monies would be available in FY 2007 to replace the \$345 million in one-time monies used to balance the original FY 2006 budget, as well as, to fund normal FY 2007 caseload growth.

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